

Brazil | The risk of further monetary tightening raises as the fiscal situation worsens

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The COPOM suggested that it will increase interest rates if the fiscal situation deteriorates further, which is more likely now after the launching of the impeachment process of President Rousseff. Anyway, our base scenario is for a stable Selic ahead, which was supported by the COPOM's forecast of inflation around the target in 2017, the monetary policy relevant horizon.

More hawkish monetary policy minutes

As expected following [last week's monetary policy decision](#), the COPOM employed a more hawkish tone in the monetary policy minutes released today. According to the monetary authority "uncertainties surrounding the balance of risks remain, mainly on the speed and composition of the process of recovery of fiscal results". For that reason, as well as for the concerns about the lengthier and sharper process of realignment of administered prices, two members of the Committee voted for an immediate adjustment of the Selic rate last week. The COPOM also highlighted the risks related to "high nominal wage increases", a likely consequence of the conjunction of high inflation and relevant indexation mechanisms (such as the rule that fixes the minimum wage). The COPOM highlighted its commitment to the targets and was more precise than before about its goals going forward: "the Committee shall take the necessary measures to ensure the fulfillment of the inflation targets, i.e. bring inflation as close as possible to 4.5% in 2016, and within the limits established by the CMN [the National Monetary Council], and make it to converge to the 4.5% target in 2017". Finally, the minutes showed that monetary authority's inflation forecasts for 2015 and 2016 were revised upward while the forecast for inflation in 2017, the most relevant horizon for monetary policy, is around the 4.5% target in the baseline scenario (and above this level in the alternative, market scenario).

We maintain our forecast of an unchanged Selic ahead

From now until its next meeting in January 19, the COPOM will monitor the evolution of the macroeconomic scenario, in particular of the impact of the fiscal situation on inflation forecasts. We are skeptical about the evolution of the fiscal adjustment, mainly after the President of the Congress Eduardo Cunha decided to launch the impeachment process of President Dilma Rousseff (even though the government seems to have enough votes to avoid the impeachment, the discussion on the issue should add to the already abnormally high political tensions and make any evolution on the fiscal side more difficult).

However, in spite of the fiscal risk, we expect the BCB to continue to see 2016 inflation within the 2.5%-6.5% target and 2017 inflation close enough to 4.5% and, therefore, to leave the Selic rate unchanged in the coming months.

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